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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 693
No. 694

315 U.S. 817

GEORGE W. COVINGTON AND KATE ELLIS COVINGTON,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

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Your petitioners, George W. Covington and Kate Ellis Covington, pray that writs of certiorari issue to review the judgment of the Circuit Court of Appeals for the Fifth Circuit in case No. 9806 decided June 9, 1941, and rehearing denied July 8, 1941. The Fifth Circuit in part affirmed the United States Board of Tax Appeals and in part reversed the Board.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 18) is reported in 42 B. T. A. 601. The opinion of the Circuit Court of Appeals (R. 50) is reported in 120 Fed. (2d) 768. Rehearing denied July 11, 1941 (R. 65).

Jurisdiction.

The jurisdiction of this Court is invoked under the provisions of Section 1141 of the Internal Revenue Code, and Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

1. Are executory contracts for the purchase and sale of Commodities on the New York Produce Exchange (R. 20), and similar exchanges, Capital Assets within the meaning of Section 117(b) of the Revenue Act of 1936?

2. If said executory contracts are Capital Assets, does the extinguishment of said executory contracts prior to the delivery date (R. 21) through the medium of the Clearing House of said exchange, involve a sale or exchange, as is required by Section 117(d) of the Revenue Act of 1936, in order that the $2,000 limitation on net losses may apply?

3. Are the Commissions paid by one engaged in the business of trading in Commodity Futures (R. 20) deductible in full as ordinary and necessary business expenses, or are they excluded by Article 24-2 of Regulations 94, promulgated under the Revenue Act of 1936?

4. If Article 24-2 of Regulations 94, promulgated under the Revenue Act of 1936, applies to Commodities as well as to Securities, does the said Article 24-2 preclude the deduction of SELLING commissions as well as purchasing commissions?

Statute Involved.

The applicable parts of the Revenue Act of 1936 and the Regulations promulgated thereunder are set forth in the Appendix.

Statement.

These causes arise in the determination of your petitioner's income tax liability for the years 1936 and 1937.

The petitioners are individuals, husband and wife, whose residence is Hazlehurst, Mississippi. George W. Covington, hereinafter referred to as the petitioner, is the president and a director of the Mississippi Cottonseed Products Co., which he organized in 1927 to consolidate and take over twelve or thirteen cottonseed processing plants then owned in large part by the petitioner.

The petitioner has been engaged for some twenty years in trading individually in commodities futures related to cotton products, including cotton, cottonseed oil, cottonseed meal, and lard. Petitioner devoted a substantial part of his time to trading of this nature during the taxable years, having almost daily transactions. He was during the taxable years a member of the New York Produce Exchange, the Memphis Cottonseed Exchange, Merchants Exchange, and the National Cottonseed Products Association. Due to these memberships, petitioner received certain information furnished by the exchanges and was entitled to reduced commission rates. Petitioner kept abreast of the current movements of the commodities through the trade journals to which he subscribed and through statistical information compiled with the assistance of a research man employed for that purpose. (R. 19-20.)

In the taxable years broker's commissions paid by the petitioner and petitioner's losses on trading in futures contracts were as follows:

	1936	1937
Trading losses	$25,120.56	$58,716.00
Commissions	2,880.00	39,619.00

The United States Board of Tax Appeals decided (1) that Commodity Futures Trading losses incurred in the years 1936 and 1937 were capital losses and subject to the $2,000 limitations of Section 117(d), Revenue Act of 1936, and (2) that commissions paid in connection with such trades were deductible but only to the extent that they are attributable to sales.

The Commissioner appealed to the Fifth Circuit (R. 27) because any commissions were allowed, and the taxpayers appealed to the Fifth Circuit (R. 37), complaining of the holding that such trading losses were capital losses and subject to the $2,000 limitation, and because all commissions were not allowed.

The Court of Appeals for the Fifth Circuit consolidated both appeals into case No. 9806 (R. 44).

The Fifth Circuit on June 9, 1941 (R. 50) sustained the Board of Tax Appeals on the points complained of by your petitioners, and reversed the Board on the point complained of by the Commissioner (R. 55). Petition for Rehearing was denied July 11, 1941 (R. 56).

The taxpayer's position is that:

As a Futures trader he does not own or acquire property. All that he does is to enter into executory contracts (R. 20), looking to the future, to buy the property referred to in the contracts. He doesn't, by his dealing, become the owner of any property, he merely enters into executory contracts which are executed, not by transfer of property, but by closing them out at a profit or loss, under the rules of the exchange, without a sale or exchange of property being involved. Future trading on Commodity Exchanges involves neither purchases in its initiation nor sales in its consummation. All that is accomplished by the public outcry on the floor of the exchange is the setting of the price and the determination of the contracting parties. The highest bidders then contract at the price set for the future delivery of the commodity. Contracts closed out before delivery are not sold. A separate sales contract is made with the high-

est bidder and the clearing house of the exchange, to which all contracts are transferred, extinguishes offsetting contracts and makes a money settlement of the price difference. There is then neither the sale nor exchange of the commodity or of the contract. There is only the extinguishment of a contract to buy and a contract to sell, and a money settlement for the price difference; and that

As a Futures trader, such being his business, he is entitled to deduct as an ordinary and necessary expense commissions paid on such trades; that Article 24-2 of Regulations 94 approved by this Court in *Helvering* v. *Winmill* (305 U. S. 79) does not relate to Commodity Trading but to expenditures of a capital nature, and therefore does not prohibit the deduction of commissions paid on trading in Commodity Futures.

Specification of Errors to be Urged.

The Circuit Court of Appeals erred:

(1) In holding that the taxpayer's losses from trading in Commodity Futures were losses incurred in the sale or exchange of capital assets and therefore limited to $2,000 in each of the years 1936 and 1937.

(2) In failing to hold that the taxpayer's losses from trading in Commodity Futures were ordinary losses resulting from the extinguishment of executory contracts involving neither a "sale" nor an "exchange."

(3) In holding that commissions paid by one engaged in the business of trading in Commodity Futures are not deductible as ordinary and necessary expenses.

(4) In failing to hold that Article 24-2 of Regulations 94 promulgated under the Revenue Act of 1936 does not apply to Commodity Trading but is confined to items of the nature of Capital Expenditures.

(5) In failing to hold that Article 24-2 of Regulations 94 promulgated under the Revenue Act of 1936, if

applicable to a trader in Commodity Futures, excludes only commissions on purchases as the commissions on sales are an ordinary and necessary expense.

(6) In failing to sustain the Board of Tax Appeals on the allowance of selling commissions as a deduction in computing net income.

(7) In failing to reverse the Board of Tax Appeals on its holding that losses incurred in trading in Commodity Futures are capital losses.

(8) In failing to reverse the Board of Tax Appeals on its holding that commissions attributable to the purchase of Commodity Futures are part of the cost of such Futures and not deductible.

Reasons for Granting the Writs.

(1) The question of whether or not losses incurred in trading in Commodity Futures are Capital losses or ordinary losses, and whether such trading involves a sale or exchange, are important questions of Federal law which have not been, but should be, settled by this Court.

The question is involved in all Revenue Acts since the 1936 Act, and will undoubtedly recur again in the administration of the 1936 and succeeding Acts. Unless certiorari is granted your petitioners may suffer irreparable injury, should this Court at a later date pass upon the question as a result of a conflict that may develop between different Circuits.

(2) The question of commissions and their treatment in the case of a trader is one of great importance, and arises under all of the Revenue Acts commencing with the Revenue Act of 1932 and including the Revenue Act of 1940.

Certiorari is now pending before you in the case of *Adolph B. Spreckles* v. *Commissioner of Internal Revenue*, No. 581-582, arising in the Ninth Circuit and in direct conflict with the decisions of the Circuit Court of Appeals for the Second Circuit in *Winmill* v. *Commissioner*, 93 Fed.

(2d) 494, and *Neuberger* v. *Commissioner*, 104 Fed. (2d) 649, both holding that selling commissions paid by a trader in securities are deductible.

Two cases in which the Board of Tax Appeals held selling commissions deductible are now pending in the Third Circuit. They are

Commissioner v. *Alice du Pont Ortiz*, 42 B. T. A. 173.
Commissioner v. *Bernon S. Prentice*, B. T. A. Memo decision, Dec. 6, 1940, Docket No. 100980.

Even though this Court may hold that commissions on securities are not deductible, the question as to commissions paid on commodities and commodity futures remains to be answered in the case at bar.

Conclusion.

For the foregoing reasons, it is respectfully submitted that this petition should be granted, commanding the Circuit Court of Appeals for the Fifth Circuit to certify and send to this Court full and complete transcripts of the record and all proceedings in the cases entitled Commissioner of Internal Revenue v. George W. Covington and Kate Ellis Covington, No. 9806, and George W. Covington and Kate Ellis Covington v. Commissioner of Internal Revenue, No. 9806, to the end that the said cases may be reviewed and determined by this Court as provided by law, and that petitioners may have such action and further relief in the premises as to this Court may seem proper.

DONALD A. CALLAHAN,
Attorney for Petitioners.

Of Counsel:
CARL J. BATTER,

October 8, 1941.